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No. 89-1784

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

THE INSURANCE COMPANY OF
THE STATE OF PENNSYLVANIA and
KERWICK & CURRAN, INC.,

Petitioners,

v.

BEN COOPER, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONERS

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63 pp

QUESTIONS PRESENTED

Congress's core/non-core distinction in 28 U.S.C. § 157 and the lack of clarity as to the bankruptcy court's authority to conduct jury trials have led to confusion among the courts over the proper scope of the bankruptcy court's jurisdiction. This case presents two questions integrally related to significant constitutional rights threatened by the Second Circuit's decision below.

I. Whether the post-petition status of the contract underlying this case requires a core designation pursuant to 28 U.S.C. § 157 even though the contract dispute could exist independent of the Chapter 11 bankruptcy proceeding and is based solely on state law claims.

II. Whether a jury trial of this case in the bankruptcy court comports with article III and the seventh amendment of the Constitution when an article I judge presides over the trial subject only to appellate review in the district court.

LIST OF PARTIES AND RULE 29.1 LIST[1]

Petitioner The Insurance Company of the State of Pennsylvania is a subsidiary of American International Group, Inc., an insurance holding company which is parent to numerous domestic property/casualty insurance companies. Said Petitioner has no subsidiaries.

Petitioner Kerwick & Curran, Inc. has no parents, subsidiaries, or affiliates.

[1] Kalvin-Miller International, Inc. did not join in the petition for a writ of certiorari, but is a party to the proceedings below as more fully described in the statement of the case herein.

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Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONERS

The petitioners, The Insurance Company of the State of Pennsylvania and Kerwick & Curran, Inc., respectfully pray that the opinion and order of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on February 7, 1990, be reversed with respect to those portions of the order which stated that the underlying dispute is a core matter and that the bankruptcy court is the proper forum for a jury trial.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit is reported at 896 F.2d 1394 (2d Cir. 1990). It appears in the appendix to the petition for a writ of certiorari at A-1.[2]

[2] References to "A-" followed by a page number indicate reference to the appendix to the petition for certiorari.

The oral opinion and order of the District Court for the Southern District of New York has not been reported. It is reprinted at J.A. 83.[3]

The oral decision and order of the Bankruptcy Court for the Southern District of New York determining that this adversary proceeding is core has not been reported. The pages of the transcript of the hearing in which the ruling appears are reprinted at J.A. 183.

The oral ruling of the District Court for the Southern District of New York directing the bankruptcy court to determine whether this adversary proceeding is core has not been reported. The transcript of the hearing in which the district court's oral ruling appears is reprinted in the Joint Appendix at J.A. 68.

The oral ruling of the Bankruptcy Court staying the prosecution of the state court action instituted by petitioner, the Insurance Company of the State of Pennsylvania, has not been reported. The transcript of the hearing in which the court so ruled is reprinted at J.A. 37.

JURISDICTION

The jurisdiction of this Court to review the order of the Court of Appeals for the Second Circuit is invoked under 28 U.S.C. § 1254(1). Certiorari was granted on June 28, 1990.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Constitutional provisions involved in this appeal are:

U.S. Const. art. I, § 8, cl. 4.

> Congress shall have the power to . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.

U.S. Const. art. III, § 1.

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold

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[3] References to "J.A." followed by a page number indicate reference to the Joint Appendix submitted herewith.

> their Offices during good Behavior, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.

U.S. Const. amend. VII.

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

The statutes involved in this appeal are 28 U.S.C. § 157 (reprinted at A-31), 28 U.S.C. § 158 (reprinted at A-33), 11 U.S.C. §§ 301 and 541(a) (reprinted in the appendix to respondent's brief in opposition to the petition at A-36) and 28 U.S.C. §§ 151 and 152(a)(1) and (e) (reprinted below).

> § 151 In each judicial district, the bankruptcy judges in regular active service shall constitute a unit of the district court to be known as the bankruptcy court for that district. Each bankruptcy judge, as a judicial officer of the district court, may exercise the authority conferred under this chapter with respect to any action, suit, or proceeding and may preside alone and hold a regular or special session of the court, except as otherwise provided by law or by rule or order of the district court.

> § 152(a)(1) . . . Each bankruptcy judge shall be appointed for a term of fourteen years, subject to the provisions of subsection (e). Bankruptcy judges shall serve as judicial officers of the United States district court established under Article III of the Constitution.

> * * *

> (e) A bankruptcy judge may be removed during the term for which such bankruptcy judge is appointed, only for incompetence, misconduct, neglect of duty, or physical or mental disability . . . .

STATEMENT OF THE CASE

The respondent, Ben Cooper, Inc. ("Cooper"), a costume and toy importer and manufacturer, filed a Petition for Reorganization under Chapter 11 of the Bankruptcy Code in April 1988. Cooper continued to operate as a debtor in possession. In the summer of 1988, Cooper retained two insurance brokers, petitioner Kerwick & Curran, Inc. ("KC") and Kalvin-Miller International, Inc. ("K-M"), to procure insurance for its business operations. In October 1988, KC and K-M obtained from petitioner The Insurance Company of the State of Pennsylvania ("ICSP") a property and general liability policy of insurance (the "Policy") covering Cooper as debtor in possession. Court of Appeals J.A. 45.*

On January 6, 1989, a fire occurred at Cooper's manufacturing facility in Rossville, Georgia. On April 13, 1989, Cooper filed proofs of loss with ICSP, claiming $699,199.64 in property damages and $1,490,580.00 in business interruption losses arising from the fire (the "Loss"). Court of Appeals J.A. 117.

ICSP's investigation of the Loss revealed that the nature of the insured's operations and facilities were not what had been represented to ICSP when coverage was initially sought. Specifically, although ICSP had been told that Cooper sought insurance on only warehouse and office locations, at least some of the facilities identified – notably including the location of the Loss – were used for manufacturing, an entirely different and more hazardous type of risk. ICSP advised Cooper that the failure to reflect the true nature of the risk voided coverage. J.A. 6. Accordingly, ICSP commenced an action against Cooper in the New York State Supreme Court, County of New York, seeking, *inter alia*, a declaration that the Policy was void *ab initio* on the ground that its issuance had been induced by material misrepresentation.

ICSP's action also sought a declaration that there was no liability under the Policy in any event because of Cooper's misrepresentations and fraudulent exaggerations relating to the Loss. At the same time that it brought suit in state court, ICSP sent

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* References to "Court of Appeals J.A." followed by a page number indicate reference to the Joint Appendix for the appeal from the United States District Court for the Southern District of New York submitted to the court below.

Cooper a notice of cancellation of the Policy based upon those misrepresentations it had raised in the suit. Court of Appeals J.A. 118.

In response to ICSP's state court action, Cooper commenced an adversary proceeding in the United States Bankruptcy Court for the Southern District of New York (the "Adversary Proceeding") seeking various forms of relief against ICSP, KC, and K-M. In its complaint, Cooper alleged that ICSP was liable under the Policy for the Loss and that the insurance company's failure to accept liability and make payment was a breach of contract. In the alternative, Cooper alleged that if the Policy were found to be void or not to provide coverage for the Loss, the lack of such coverage would have been the result of the negligence of its brokers, KC and K-M. Cooper sought money damages in excess of $2,000,000 from all defendants as well as punitive damages in the sum of $5,000,000 from ICSP. J.A. 134.

When it commenced the Adversary Proceeding, Cooper also moved the bankruptcy court by order to show cause for a stay of ICSP's previously filed state court action on the ground that the controversy was a core matter as defined by the Bankruptcy Amendments and the Federal Judgeship Act of 1984 (the "BAFJA") and should be adjudicated in the bankruptcy court. Cooper also sought to stay ICSP's cancellation of the Policy. J.A. 19, 34.

In its answer to Cooper's complaint, ICSP pleaded that the bankruptcy court lacked jurisdiction and also raised by way of defense the same matters it had alleged in its state court complaint. In addition, ICSP demanded a jury trial, as did KC and K-M in their answers to Cooper's complaint. J.A. 140.

The Honorable Cornelius Blackshear, U.S.B.J., (United States Bankruptcy Court for the Southern District of New York) granted Cooper the relief it had sought in its motion by order to show cause. In a May 17, 1989 hearing, Judge Blackshear, ruling from the bench, stayed the state court action, enjoined cancellation of the Policy, and ordered expedited discovery. J.A. 37.

Following Judge Blackshear's ruling, ICSP, joined by KC and K-M, applied to the United States District Court for the Southern District of New York for an order lifting the stay of the state court

proceeding and withdrawing the reference to the bankruptcy court on the ground that the bankruptcy court was without jurisdiction to grant the relief provided in its order. In a hearing on May 31, 1989, the Honorable John M. Walker, U.S.D.J., declined to rule on the substance of the application until the bankruptcy court resolved the threshold issue of whether the Adversary Proceeding was a core or non-core proceeding under the BAFJA. Accordingly, the district court remanded the matter to the bankruptcy court for such determination. J.A. 68. On June 15, 1989, oral argument was heard before Judge Blackshear, who ruled from the bench that the Adversary Proceeding was core pursuant to 28 U.S.C. §§ 157(b)(2)(A) (estate administration) and (L)(confirmation of plans). At the hearing, Judge Blackshear expressed skepticism as to whether ICSP and its co-defendants were entitled to a jury trial. He concluded, however, that in view of his finding that the Adversary Proceeding was core, the matter would remain within the bankruptcy court for plenary adjudication and fact finding. J.A. 83.

Following the bankruptcy court's ruling that Cooper's proceeding was core, ICSP, KC, and K-M moved the district court for relief from the bankruptcy court's initial order. In an oral ruling on July 11, 1989, the Honorable Louis L. Stanton, U.S.D.J., reversed Judge Blackshear's ruling and lifted the stay of the state court proceeding on the ground that the bankruptcy court was without jurisdiction under the circumstances; withdrew the reference to the bankruptcy court; and abstained from exercising jurisdiction in the district court. In addition, Judge Stanton lifted the stay which had enjoined ICSP from canceling the Policy. The district court found that the controversy, which concerned only state law issues as to an insurance company's liability for a loss sustained by an insured, was not rendered core merely because its resolution might bring funds into, or otherwise affect administration of, a bankruptcy estate. The district court's withdrawal of the reference was also based in part on the finding that ICSP and its co-defendants were entitled to a jury trial. Judge Stanton concluded that the requirement of district court *de novo* review of findings of fact in a non-core matter would be incompatible with the conduct of a jury trial in the bankruptcy court. J.A. 183.

Cooper appealed the district court's ruling which had lifted the stay. The court of appeals reversed the district court, in part, holding that the proceeding was core because the underlying contract, the Policy, had been entered into subsequent to the filing of Cooper's bankruptcy petition. Therefore, the Second Circuit reasoned, the resolution of the dispute would necessarily affect administration of the estate. The court of appeals further held, however, that all of the defendants were entitled to a jury trial, and that such jury trial should be conducted by the bankruptcy court. A-1.

On May 8, 1990, ICSP and KC filed a petition for a writ of certiorari in this Court to review certain portions of the decision of the court of appeals. Certiorari was granted on June 28, 1990.

SUMMARY OF ARGUMENT

A.

The court of appeals below concluded that under the Bankruptcy Amendments and the Federal Judgeship Act of 1984 a dispute between an insurer and its insured over a claim under an insurance policy is a core matter by virtue of the fact that the insurance contract was issued post-petition to a debtor in possession. In arriving at its conclusion, the court gave an expansive reading to the BAFJA while virtually ignoring the Court's dictates in *Marathon*, even though the BAFJA constitutes nothing more than Congress's attempt to implement the essence of what the Court held in *Marathon* with respect to the constitutional limits of an article I court's jurisdiction.

Under the rule in *Marathon*, Congress cannot vest in non-article III courts the power to adjudicate basic state law contract claims. Rather, a bankruptcy court's jurisdiction is circumscribed. It is limited to the adjudication of matters which are at the heart of the operation of the bankruptcy system itself and the specialized matters which are unique to bankruptcy, *e.g.*, the allowance or disallowance of claims, turnover proceedings, the discharge of debts, the distribution of proceeds, and the liquidation of assets. The Second Circuit failed to evaluate the subject dispute in terms of whether it arose under title 11 or in a title 11 case. Clearly, an insurance coverage dispute would not fit either category under 28 U.S.C. § 157(b)(1). The matter would be non-core — outside the bankruptcy court's jurisdiction.

Instead of giving effect to 28 U.S.C. § 157, the court of appeals seized upon the fact that the contract at issue was entered into post-petition, notwithstanding that under *Marathon*, the distinction is of no importance. Whether an insurance contract giving rise to a disputed claim was entered into pre-petition or post-petition does not change the character of a dispute, nor does it transform an otherwise ordinary state law contract claim into a matter at the heart of the bankruptcy powers, a pre-requisite to a proper core designation under *Marathon*. The claim in this case concerns private rights, outside the scope of article I adjudication.

B.

The petitioners, having made a timely demand, are entitled to a trial by jury in an article III court. In *Granfinanciera* the Court held that the seventh amendment right to a jury trial cannot be compromised merely because the underlying dispute is with a debtor in possession. The nature of the controversy, in this case a contract law claim which will be resolved on the basis of state law, is determinative of petitioners' jury trial right. Since under 28 U.S.C. § 157(c)(1) there is *de novo* review of findings of fact in a non-core matter, an initial jury trial of such a matter in the bankruptcy court would not only be a useless exercise, wasteful of judicial resources, but would also violate the seventh amendment, which proscribes reexamination of findings of fact under such circumstances. Accordingly, a jury trial of a non-core matter cannot take place in the bankruptcy court.

As a separate consideration, it is clear that Congress did not intend under the BAFJA that bankruptcy judges conduct jury trials in cases such as this. The statute does not contain any express provision so empowering the bankruptcy judges and a review of the legislative history discloses no indication that Congress contemplated the conduct of jury trials in the bankruptcy court.

Independent of the analysis of any statutory provision, article III prohibits the conduct of jury trials in the article I bankruptcy courts. The Court's pronouncements in *Marathon* and *Granfinanciera* lead ineluctably to the conclusion that in any matter which, by its nature, would give rise to a seventh amendment right of trial by jury, relegation of that jury trial to an article I court would be in violation of article III.

ARGUMENT

I. THE UNDERLYING DISPUTE IS A NON-CORE RELATED MATTER UNDER THE BANKRUPTCY AMENDMENTS OF 1984.

A. Background Of This Jurisdictional Dispute.

Petitioner ICSP is one of many non-debtor/non-creditor litigants to be swept unwilling into the "maze"[5] or "maelstrom"[6] of litigation concerning the proper extent of bankruptcy court jurisdiction under the Bankruptcy Amendments and the Federal Judgeship Act of 1984 (the "BAFJA"). ICSP finds itself facing these issues by virtue of its having sued in state court for a declaration as to whether it is liable under a policy of insurance it issued to a company which happened to be a debtor in possession. In response, the debtor in possession instituted an adversary proceeding against ICSP in the bankruptcy court seeking, *inter alia*, contract damages and punitive damages from ICSP. The debtor's position, which was upheld by the court of appeals below, was that its dispute with ICSP and the brokers who placed the insurance coverage is properly designated as a core matter under 28 U.S.C. § 157 and can be disposed of in a non-article III bankruptcy court. ICSP contends that the underlying dispute, which originated in, and is controlled by, state common law, must be adjudicated in a federal district court or a state court.

The court of appeals below, following the First Circuit's decision in *Arnold Print Works, Inc. v. Apkin*, 815 F.2d 165 (1st Cir. 1987), concluded that the issuance of the Policy post-petition *ipso facto* rendered the dispute a core proceeding. It is submitted that this rule does not comport with this Court's interpretation of the requirements of article III of the Constitution as set forth in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) and *Granfinanciera, S.A. v. Nordberg*, ____U.S.____, 109 S.Ct. 2782 (1989). This Court need not find the BAFJA unconstitutional in order to hold that the underlying

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[5] *In re S.E. Hornsby & Sons Sand and Gravel Co.*, 45 Bankr. 988, 990 (Bankr. M.D. La. 1985).

[6] *Satelco, Inc. v. North American Publishers, Inc. (In re Satelco, Inc.)*, 58 Bankr. 781, 783 (Bankr. N.D. Tex. 1986).

dispute is non-core. The reasoning of such cases as *Wood v. Wood (In re Wood)*, 825 F.2d 90 (5th Cir. 1987) and *Piombo v. Castlerock Properties (In re Castlerock Properties)*, 781 F.2d 159 (9th Cir. 1986), demonstrates that the BAFJA does not mandate reference of the underlying dispute to the bankruptcy court. Those cases hold, as did the district court below, that core matters are those "which seek the creation, recognition, determination or adjudication of rights which do not exist independently from Title 11 or the bankruptcy case itself." J.A. 184. See discussion of *Wood* and *Castlerock* at 20-22, *infra*.

The court of appeals below stated that its interpretation and application of the BAFJA was consonant with Congress's intent that the bankruptcy court's jurisdiction be as broad as would be possible without violating constitutional proscriptions. A-9, 10. In pursuing that goal, however, the court of appeals failed to give sufficient consideration to the context in which the statute came into being, to wit, as a response to this Court's pronouncements in *Marathon*, a case which, itself, was the product of a substantial history. Unfortunately, the court below swallowed the rule of *Marathon* and disregarded the guidelines of *Granfinanciera*. The BAFJA should not be interpreted to sweep this *Marathon*-type action into the core jurisdiction of an article I bankruptcy court.

B. Jurisdiction Conferred By The BAFJA Must Be Construed In Light Of The *Marathon* Decision.

Bankruptcy jurisdiction in this country has a bedeviled and befuddling history reaching back more than a century. The current daily wrangling over core versus non-core designation of a civil proceeding is reminiscent of the constant litigation engendered by the summary/plenary distinction under the Bankruptcy Act of 1898 (the "1898 Act").[7] The Bankruptcy

[7] The 1898 Act provided a convoluted, bifurcated jurisdictional scheme. Non-article III bankruptcy referees were permitted to exercise "summary jurisdiction" over disputes under limited circumstances. Controversies over property not in the possession of the bankruptcy court where the adverse party's claim was more than colorable were heard in plenary proceedings in the district court if an independent basis of jurisdiction existed; otherwise such controversies were heard in the state court. Under the 1898 Act, without the consent of the litigants, a

(Footnote continued)

Reform Act of 1978 (the "1978 Act"), whose jurisdictional provision was struck down in *Marathon*, was enacted in part to eliminate the time-consuming jurisdictional challenges which had become a routine matter under the 1898 Act. The 1978 Act abolished the confusing distinction between summary and plenary jurisdiction and permitted all disputes related to a bankruptcy case to be brought before the non-article III bankruptcy judges.[8]

In *Marathon*, the Court addressed the question of whether Congress could vest in a non-article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, subject only to ordinary appellate review. *Marathon*, 458 U.S. at 84. The majority held[9] that Congress could not so act. *Marathon* invalidated the sweeping grant of bankruptcy court jurisdiction provided by the 1978 Act.

The BAFJA was enacted in response to the *Marathon* decision. In the BAFJA, Congress attempted to redress the constitutional infirmities of the 1978 Act's jurisdictional provisions by distinguishing "core" proceedings (claims arising in and under Title 11) from "non-core" proceedings (claims "related" to Title 11 cases) that is, traditional claims arising under state law. Congress derived the "core" concept from the *Marathon* decision, which confined the proper scope of a non-article I bankruptcy court to the "restructuring of debtor-creditor relations, which is at the core of the federal

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Marathon-type suit would have required a plenary proceeding. *Harrison v. Chamberlin*, 271 U.S. 191, 193-194 (1926).

Justice Brennan, writing for the plurality in *Marathon*, called into question the constitutionality of the entire referee system in bankruptcy matters: "Appellants and Justice White's dissent also rely on the broad powers exercised by the bankruptcy referees immediately before the Bankruptcy Act of 1978. . . . But those particular adjunct functions, which represent the culmination of years of gradual expansion of the power and authority of the bankruptcy referee, (citation omitted), have never been explicitly endorsed by this Court." *Marathon*, 458 U.S. at 79 n. 31.

[8] Subsection (c) of § 1471 of the 1978 Act (struck by *Marathon*) stated:

> The bankruptcy court for the district . . . shall exercise all of the jurisdiction conferred by this section on the district courts.

[9] Two justices concurred in the judgment announced by the plurality opinion.

bankruptcy power." *Marathon*, 458 U.S. at 71. The remedy the BAFJA supplies for the 1978 Act's jurisdictional infirmities is the denial to the bankruptcy court of power to enter a final order in non-core matters.

Case law demonstrates that the BAFJA must be tempered by reference to the principles enunciated in *Marathon* and *Granfinanciera*. The court below failed to confront the teaching of those cases and returned the parties to the pre-*Marathon* era. Yet, other courts have demonstrated that the BAFJA, construed as the post-*Marathon* product which it is, can properly be read without infringing upon the constitutional rights of litigants. Indeed in *Granfinanciera* this Court looked beyond the literal meaning of §157(b)(2)(H) to discern the common-law nature of the underlying fraudulent conveyance dispute, which entailed a jury-trial right and, by implication, an entitlement to an article III forum.

C. The Underlying Case Is Non-Core Since It Does Not Arise Under Title 11 Or In A Title 11 Case.

The core/non-core dichotomy is the essence of the jurisdictional system designed by Congress in the wake of this Court's invalidation of 28 U.S.C. § 1471 in *Marathon*. The core/non-core determination has significant substantive and procedural consequences, because the bankruptcy court's jurisdiction over non-core matters is restricted as compared to its jurisdiction over core matters.

The BAFJA does not require the district courts to refer bankruptcy cases to the bankruptcy courts, but allows them to do so. Section 157(a) permits the district court to make a general reference of all Title 11 cases and proceedings to the bankruptcy judge. 28 U.S.C. § 157(a) provides that district courts may refer "cases under title 11 and any or all proceedings arising in or related to a case under title 11" to bankruptcy judges. Of the cases referred to them pursuant to § 157(a), bankruptcy judges are authorized to "hear and determine" "cases under title 11" and "core proceedings" arising under Title 11. 28 U.S.C. § 157(b) (Supp. V 1988). The "cases under title 11" and "core proceedings" heard and determined by bankruptcy judges pursuant to § 157(a) and (b) are subject to review by a district court "in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts." 28 U.S.C. § 158(c) (Supp. V 1988).

Non-core proceedings related to cases under Title 11 may also be referred to bankruptcy judges pursuant to 28 U.S.C. § 157(a). However, unless the parties stipulate otherwise, bankruptcy judges are authorized only to "hear" non-core proceedings referred to them and submit proposed findings of fact and conclusions of law to the district court for *de novo* review. 28 U.S.C. § 157(c)(1).

To fall within the "core" category of proceedings in which a bankruptcy court may enter a final order, a civil proceeding must either arise under a provision of Title 11; or "arise in" the Title 11 bankruptcy case (28 U.S.C. 157(b)(1)). The statute does not define core proceedings.[10] Subsection (b)(2) does provide a non-exclusive list of matters that are "core." There are thirteen rather specifically described types of proceedings, and two "catchall" provisions, "A" and "O." Numerous commentators have noted that the two catchalls, if broadly construed, could embrace every conceivable matter (including what was at issue in *Marathon*) that could have any effect on a bankruptcy case. *See, e.g., Sokol v. Massachusetts Life Ins. Co. (In re Sokol)*, 60 Bankr. 294, 297 (Bankr. N.D. Ill. 1986) (*see* discussion at 24-25, *infra*).

An insurance dispute seeking proceeds of a policy and a declaration that coverage is in effect is not an enumerated core matter. This fact alone, taken in the light of the BAFJA background and the nature of the list of core matters in 28 U.S.C.

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[10] The failure to provide a specific and exhaustive definition of core proceedings has resulted in considerable confusion. "The term 'core proceedings' is a new term of art, coined to describe the concept of foreshortened jurisdictional boundaries of bankruptcy courts. Only time and case law can bring the concept out of the chiaroscuro of new legislation into well-rounded and comprehensive definition." *Allis-Chalmers Corp. v. Borg-Warner Acceptance Corp., (In re D.C. Huff Co. Inc.)*, 44 Bankr. 129, 134 (Bankr. W.D. Ky. 1984).

It is noteworthy that the Judicial Conference of the United States, which drafted the post-*Marathon* Model Emergency Rule delineated "related proceedings" in which bankruptcy judges were not permitted to enter final orders as "civil proceedings which, in the absence of a petition in bankruptcy, could have been brought in a district court or a state court." Model Emergency Rule § (d)(3)(A), reprinted in 1 *Collier on Bankruptcy* (15th ed.) ¶ 3.01(1)(b)(vi).

§ 157(b)(2), leads to the conclusion that such a dispute is not core.[11] Even if it were included within the literal language of one of the illustrative core proceedings, it would still not be appropriate for final resolution by a bankruptcy court unless it "arose under" a provision of Title 11; or "arose in" the Title 11 bankruptcy case.

Because the wording of the illustrative core proceedings is vague and ostensibly all-encompassing, courts refer back to the basic grant of reference (of "all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11," 28 U.S.C. § 157(b)(1)) to determine whether the matter may properly be considered core. Thus, in *Satelco, Inc. v. North American Publishers, Inc. (In re Satelco, Inc.)*, 58 Bankr. 781 (Bankr. N.D. Tx. 1986), the debtor had sought to bring a state law contract action into the bankruptcy court as a core proceeding under 28 U.S.C. §157(b)(2)(E), "orders to turn over property of the estate." The court distinguished the state-law action, which was non-core, from the core turnover proceeding which would follow it and would properly take place before the bankruptcy court. The court in *Dekalb Medical Bldg. Partnership v. Sturm (In re Sturm)*, 66 Bankr. 325, 327 (Bankr. N.D. Ill. 1980), applied a similar analysis to a proceeding in which the debtor's complaint invoked core jurisdiction under 28 U.S.C. § 157(b)(2)(I) ("determinations as to the dischargeability of particular debts"). The court held that the state-law contract claim had to be liquidated in the district court, before the dischargeability issue, which arises under 11 U.S.C. § 523(a)(2), could be determined in the bankruptcy court.[12]

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[11] "Claims (whether state-law or not) by the debtor against a non-creditor do not appear in the list of 'core proceedings' given in § 157 (b)(2). True, § 157(b)(2) expressly states the list is illustrative and not exhaustive, but because the list given is extensive, specifically includes one kind of claim made by debtors (namely, counterclaims against creditors; see § 157(b)(2)(C)), and because claims against non-creditors are an important category of cases very much on Congress' mind when the 1984 Act was passed [citing *Marathon*], this court concludes that if Congress had wanted this kind of case to be considered a core proceeding it would have included it in the given list." *UNR Industries, Inc. v. Continental Ins. Co.*, 623 F. Supp. 1319, 1332 (D.C. Ill. 1985).

[12] The "arising in/arising under" analysis performed by some courts is identical to the analysis other courts perform in applying the *Marathon* decision to clarify the statutory provisions. The crux of the exercise is to decide what is core under *Marathon* and determine jurisdiction accordingly.

Clearly, the underlying case is not a claim grounded on any provision of the Bankruptcy Code. Nor does the suit arise in a Title 11 case. The Fifth Circuit explained the meaning of proceedings "arising in" a case under Title 11 as "administrative matters that arise *only* in bankruptcy cases." *Wood v. Wood (In re Wood)*, 825 F.2d 90, 97 (5th Cir. 1987).[13] Distribution of proceeds of an insurance policy may be an administrative matter that "arises in a Title 11 case." The determination of the insurer's liability on a policy, however, is entirely independent of bankruptcy administration and in no sense can be said to arise under Title 11 or in a Title 11 case.[14]

The factual circumstances of Cooper's claim – that the Policy was issued during the pendency of the Chapter 11 case and that the proceeds, if any, will become property of the estate for distribution – do not mean that the suit on the Policy itself turns on any federal rule of decision. The insurance suit, which was brought originally in state court by the petitioner ICSP, has an existence independent of any type of bankruptcy case under the Bankruptcy Code.

II. THE UNDERLYING INSURANCE DISPUTE, WHICH CONCERNS ONLY PRIVATE RIGHTS, FALLS SQUARELY WITHIN THE RULE OF *MARATHON* AND THUS MUST BE A NON-CORE RELATED PROCEEDING.

Independent of any right under the BAFJA, petitioners have a constitutional right, under *Marathon* and *Granfinanciera*, to an article III forum. The court below improperly designated as a core matter a suit involving only state-created private rights. The relegation of post-petition contract disputes to an article I forum would deprive petitioners of constitutional guarantees under article III.

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[13] *Accord, Atlas Automation, Inc. v. Jensen, Inc. (In re Atlas Automation, Inc.)*, 42 Bankr. 246 (Bankr. E.D. Mich. 1984); *Dakota Grain Systems, Inc. v. Rauser Constr., Inc. (In re Dakota Grain Systems, Inc.)*, 41 Bankr. 749 (Bankr. D.N.D. 1984); *Weeks v. Kramer (In re G. Weeks Securities, Inc.)*, 89 Bankr. 697, 705 (Bankr. W.D. Tenn. 1988).

[14] The interpretation of "arising in" jurisdiction exemplified in *Wood* (and in the 9th Circuit case of *Castlerock* – see discussion at 20-22, *infra*) results in a constitutionally permissible scope of article I jurisdiction, gauged by the *Marathon* standard.

A. Article I Jurisdiction Over The Underlying Dispute Is Improper Under *Marathon*.

Cooper argued below that its adversary proceeding against ICSP was core under "at least" four provisions of 28 U.S.C. §157(b)(2): subsection (A) (administration of the estate); subsection (E) (turnover of estate property); subsection (L) (confirmation of plans); and subsection (O) (other proceedings affecting the liquidation of the estate or adjustment of the debtor-creditor relationship).[15] The bankruptcy court determined that it had jurisdiction under subsections (A) and (L). J.A. 112. The court of appeals found jurisdiction under subsection (A). A-12. ICSP maintains that the underlying insurance dispute, however denominated, cannot be adjudicated by a non-article III tribunal. If the present dispute is a core matter, then the proceeding involved in *Marathon* would be a core matter. Any application of the BAFJA which extends core jurisdiction over a purely state common-law dispute to an article I court, with only ordinary appellate review by an article III court, is constitutionally infirm under *Marathon*.

In *Marathon*, the Northern Pipeline Construction Company, which had filed a petition for reorganization, sued Marathon Pipe Line Company ("Marathon") in bankruptcy court for, *inter alia*, breach of contract and warranty. Marathon, like petitioner ICSP here, had filed no claim against the bankruptcy estate. The plurality opinion emphasized there that such state-law causes of action are "paradigmatic private rights, even when asserted by an insolvent corporation in the midst of chapter 11 reorganization proceedings." *Granfinanciera*, 109 S.Ct. at 2786, *citing Marathon*, 458 U.S. at 71. The majority of the *Marathon* Court held that article I jurisdiction over such a dispute impermissibly encroached upon the powers vested by article III in the judiciary.

Thomas v. Union Carbide Agr. Products Co., 473 U.S. 582, 584 (1985), concisely set out the narrow holding of *Marathon*:

> The Court's holding in that case establishes only that Congress may not vest in a non-Article III court the

[15] *See* brief of plaintiff-appellant Cooper in the court of appeals p. 15.

> power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review. 458 U.S. at 84, 102 S.Ct. at 2878 (plurality opinion); *Id.* at 90-92, 102 S.Ct. at 2881-2882 (opinion concurring in judgment); *Id.* at 92, 102 S.Ct. at 2882 (Burger, C.J., dissenting).

ICSP is not a creditor and has filed no claim against the bankruptcy estate. This case is nothing more than a garden-variety dispute between insurer and insured over a claim. The Bankruptcy Code is completely irrelevant to the disposition of the insurance claim. The Policy was a standard one, in no way different from a policy issued to a non-debtor. The underlying claim originates in state law, concerns private contractual rights – like the rights at issue in *Marathon* – and stands completely clear of the "core of the bankruptcy powers." *Marathon*, 458 U.S. at 71.

The only connection of this dispute to Cooper's Chapter 11 plan is that if Cooper's suit is successful, a sum of money would come into the bankruptcy estate. A *Marathon* analysis of whether that fact alone moves a controversy to the very heart of the bankruptcy powers leads quite clearly to one conclusion: it does not. Numerous courts have recognized that such a slight nexus to bankruptcy administration does not confer core bankruptcy jurisdiction.[16] This dispute is not tied to the administration of a

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[16] *See, e.g., Pryor v. Continental Ins. Co. (In re Blue Point Carpet, Inc.)*, 86 Bankr. 327, 328 (Bankr. E.D.N.Y. 1988) ". . . even in the more difficult case where a breach of contract action is necessary to fund a reorganization, treatment of the matter as a core proceeding is still unjustified. . . ." In *Chiodo v. NBC Bank Brooks Field (In re Chiodo)*, 88 Bankr. 780 (W.D. Tex. 1988) the outcome of the action on a note would have obviously "affected" the estate since at issue was one of the largest claims against the estate and liens against much of the property of the estate. Although the creditor had filed a proof of claim, the proceeding was held to be non-core. "The . . . complaint does not invoke any rights provided by Title 11 but asserts only rights under Texas law." *Chiodo* at 782. The possibility that a proceeding will substantially affect a bankruptcy, because money may be recovered and property be unencumbered to pay other creditors and support the reorganization efforts, does not transform

(Footnote continued)

plan. If money is recovered, it will be distributed under the plan, but whether or not there is entitlement to recovery is a far different matter.

B. The Judicially Fashioned Pre-Petition/Post-Petition Distinction Does Not Comport With *Marathon*.

The court of appeals below and the Court of Appeals for the First Circuit (in *Arnold Print Works, Inc. v. Apkin*, 815 F.2d 165 (5th 1987)) confined the *Marathon* holding to pre-petition contracts. *Marathon*, however, extended its holding to traditional state common law actions subject to no federal rule of decision, that are before the bankruptcy court "only because the plaintiff has previously filed a petition for reorganization in that court." *Marathon*, 458 U.S. at 90 (Rehnquist and O'Connor, J.J., concurring in the judgment). The narrow holding of *Marathon* enunciated in the concurring opinion clearly embraces the underlying insurance dispute. *Id.*

The cases restricting the rule of *Marathon* to pre-petition contracts are grounded on one phrase from the opinion in that case: "[A]ppellant Northern's claim for damages and breach of contract and misrepresentation involves a right created by *state* law [emphasis in original], a right independent of and *antecedent to* [emphasis added] the reorganization petition that conferred jurisdiction upon the Bankruptcy Court." 458 U.S. at 84. It was an incident of the suit in *Marathon* that the contract at issue and the action on the contract came into being pre-petition. That incident, however, was not the turning point of the *Marathon* decision. The turning point was the traditional, common-law nature of the claim asserted by the debtor.

The Second Circuit below determined that the underlying suit was "integral to the estate administration" because the insurer had

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the nature of the state law liability suit. *Id.*; *see also, Braucher v. Continental Illinois Nat'l. Bank and Trust Co. of Chicago (In re Illinois-California Exp., Inc.)*, 50 Bankr. 232 (Bankr. D. Colo. 1985). In *Johnson v. State Farm Mutual Automobile Ins. Co. (In re Guenther)*, 65 Bankr. 650 (Bankr. D. Colo. 1986), a bad-faith failure-to-settle suit of trustee against debtor's insurer was deemed non-core, although the potential recovery on the policy was the entire property of the debtor's estate.

knowingly contracted with one who was a debtor in possession; the insurance concerned an estate asset; and adequate insurance had been made a premise of the confirmation of Cooper's reorganization plan. The court of appeals noted that "historically, trustees and debtors in possession. . . have been viewed as officers of the bankruptcy court." A-11.[17]

Bankruptcy confers no special entitlement to insurance coverage nor does it confer special rights under an insurance contract which would create bankruptcy court jurisdiction where none otherwise would exist. The proposition that a contract is not rewritten by the Bankruptcy Code is widely accepted.[18] The court below stated baldly, "Logically, a post-petition contract that has as its subject matter an estate asset must be analyzed differently than one arising pre-petition." A-11. The court below omitted to explain *how* the analysis of a post-petition contract "must differ" from the analysis of a pre-petition contract. The court presents two reasons why the analysis must differ: because with the petition the bankruptcy estate is created and "[m]oreover,. . . the filing date adjusts 'the rights of others connected with the proceeding.' " A-11.[19] These facts provide no answer to the question: how is the post-petition contract – in this instance, the basis of the insurer's liability – to be analyzed differently? This case is like *Marathon* and *Granfinanciera*: state law must determine state-created rights, and then bankruptcy jurisdiction is properly invoked to supervise distribution of proceeds.

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[17] Referring to *Arnold Print Works, Inc. v. Apkin*, 815 F.2d at 169-70.

[18] "[It is a] general principle of bankruptcy law that the Code does not enlarge a party's rights created under state or federal law except to the extent that such expansion is expressly or by necessary implication afforded by the Code. . . . [T]he Code does not augment the rights of a debtor under a contract nor prevent termination of a contract by its own terms." *Heaven Sent, Ltd., v. Centennial Ins. Co. (In re Heaven Sent, Ltd.)*, 50 Bankr. 636, 638 (Bankr. E.D. Pa. 1985).

[19] Quoting King, 4 *Collier on Bankruptcy* ¶ 541.04 at 541-22 (15th ed. 1989).

Cases dealing with pre-petition insurance contract disputes uniformly find them to be non-core matters.[20] There appears to be no distinction between suits based on pre-petition insurance contracts and suits on post-petition contracts which could rise to a constitutional level of significance. The controlling law is in both cases state common law. The parties are private, not governmental entities. Why the post-petition timing of the contract should operate to strip a non-creditor party of an article III entitlement has not been made clear by the court of appeals below or by the First Circuit in *Arnold Prints Works*. It should be borne in mind that, to the extent that these cases rely on jurisdiction permitted under the 1898 Act, the old referee system was never approved by this Court (see n. 8, *supra*).

The core or non-core status of a proceeding must be determined on a case-by-case basis. A bright line should not be drawn at the moment of the filing of the petition. The fact that a bankruptcy court confirms a plan including a general provision for insurance cannot confer jurisdiction on an article I court to render final judgment in a purely state common-law insurance dispute. The reorganization plan's requirement of insurance coverage does not inextricably interweave the standard insurance contract with any federal rule of decision.

A Ninth Circuit decision, *Piombo v. Castlerock Properties (In re Castlerock Properties)*, 781 F.2d 159 (9th Cir. 1986), and a Fifth Circuit decision, *Wood v. Wood (In re Wood)*, 825 F.2d 90 (5th Cir. 1987), offer an analysis of the core/non-core distinction which is more persuasive in light of *Marathon* than is the opinion below. The court in *Wood*, presented with a post-petition contract claim, held that core matters are those controversies which "implicate the peculiar rights and powers of bankruptcy or, in Justice Brennan's words, controversies 'at the core of the federal bankruptcy

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[20] *See, e.g., Rosen-Novak Auto v. Honz*, 783 F.2d 789 (8th Cir. 1986); *In re Pied Piper Casuals, Inc.*, 72 Bankr. 156 (S.D.N.Y. 1987); *UNR Industries, Inc. v. Continental Ins. Co.*, 623 F. Supp. 1319 (N.D. Ill. 1985); *Sullivan v. Maryland Casualty Co. (In re Ramex Int'l, Inc.)*, 91 Bankr. 313 (E.D. Pa. 1988); *R.I. Lithograph Corp. v. Aetna Casualty and Surety Co.*, 60 Bankr. 199 (Bankr. D. R.I. 1986); *A.I.A. Industries, Inc. v. Equitable Life Assurance Soc'y (In re A.I.A. Industries, Inc.)*, 75 Bankr. 1013 (Bankr. E.D. Pa. 1987).

power.' " *Wood* at 96. The court went on to state that "controversies that do not depend on the bankruptcy laws for their existence—suits that could proceed in another court even in the absence of bankruptcy—are not core proceedings." *Id.*[21]

Wood examined the language of subsection 157(b)(1) which vests full judicial power in bankruptcy courts over "core proceedings arising under Title 11, or arising in a case under Title 11." Section 157 equates core proceedings with the categories of "arising under" and "arising in" proceedings. The court explained that "arising under" proceedings involve a cause of action created or determined by a statutory provision of title 11. It interpreted "arising in proceedings" as those "administrative" matters that arise *only* in bankruptcy cases. "In other words, 'arising in' proceedings are those that are not based on any right expressly created by title 11, but nevertheless, would have no existence outside of the bankruptcy." *Wood*, 825 F.2d at 97.

The plaintiff in *Wood* had argued that his action was "literally a claim against the estate, which is expressly defined as a core proceeding by section 157(b)(2)(B)." *Id.* at 97. In rejecting this argument, the court explained that to determine the nature of a proceeding, it needed to look to both the form and the substance of the proceeding. The court further indicated that the issue in *Wood* was "whether the defendants are liable to the plaintiff under state law. The suit does not raise as primary issues such matters as dischargeability, allowance of the claim, or other bankruptcy matters." *Id.* at 98. Thus, while the court recognized that final judgment in the contract dispute in *Wood* might lead to proceedings to allow the claim or discharge the debt, those concerns were not "primary issues," but rather speculative and insubstantial. *Id.*

Applying the *Wood* analysis to the present case, Cooper's claim against its insurer concerns liability on a contract under state law. Although the insured is a debtor which is required to maintain

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[21] The *Wood* court's test for core proceedings has been adopted in *Gower v. Farmers Home Administration (In re Davis)*, 899 F.2d 1136, 1140-1141 (11th Cir. 1990); and *Barnett v. Stern*, ____F.2d____, 1990 WL 108866 (7th Cir. Aug. 2 1990). The court in *Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1156 (3d Cir. 1989) cited the *Wood* formulation with approval.

insurance as part of its reorganization plan, that connection to the bankruptcy case is inadequate to support final determination by the bankruptcy court. This matter, which does not arise under any provision of Title 11, and is not unique to a bankruptcy context, falls outside the core category.

In *Castlerock*, the controversy was a debtor's state-law contract counterclaim which was originally brought in state court before a proof of claim was filed. The court declined to find core status under § 157(b)(2)(C) ("counterclaims by the estate against persons filing claims against the estate"), on the theory that the proof of claim was filed by the claimant after the state-law contract action had been commenced in state court and removed by the debtor to the bankruptcy court. The court also declined to find core status under either of the catchall provisions, § 157(b)(2)(A) ("matters concerning the administration of the estate"), or § 157(b)(2)(O) ("other proceedings affecting the liquidation of the assets of the estate"). Noting many cases which had held contract claims arguably within those provisions to be non-core, the court emphasized that a core characterization should be avoided if it may raise constitutional problems.

> [T]he apparent broad reading that can be given to § 157(b)(2) should be tempered by the *Marathon* decision. *American Energy*, 50 B.R. at 178.
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> This Circuit has interpreted *Marathon* as depriving the bankruptcy court of jurisdiction "to make final determinations in matters that could have been brought in a district court or a state court." *Thomas*, 765 F.2d at 929.

Castlerock, 781 F.2d at 162.

Wood and *Castlerock* implement the spirit of the *Marathon* decision by restricting core jurisdiction to matters "at the core of the bankruptcy powers"—matters originating in bankruptcy law, or turning on bankruptcy law, which could not have been brought in the first instance in state court. Under a *Wood-Castlerock* analysis, the present insurance dispute is a simple

state-law claim whose connection with the bankruptcy case is, upon examination, peripheral and incidental.

A number of courts have struggled with the seemingly all-encompassing scope of what is "core" under the BAFJA and have recognized that a literal and broad reading which ignores *Marathon* would not be proper. For example, in *A.I.A. Industries, Inc. v. Equitable Life Assurance Soc'y (In re A.I.A. Industries, Inc.)*, 75 Bankr. 1013 (Bankr. E.D. Pa. 1987), the debtor contended that a suit to recover on an insurance policy was a core matter under § 157(b)(2)(A) ("matters concerning the administration of the estate"), (B) ("allowance or disallowance of claims"), (C) ("counterclaims by the estate against persons filing claims against the estate"), and (O) ("other proceedings affecting liquidation"). The court conceded that the wording of certain of these subsections could be read to embrace the proceeding in question.

> However, as we pointed out in *Windsor*, 67 B.R. at 695, a broad reading of the subsections of this statutory provision would result in a conclusion that practically every conceivable proceeding is a core proceeding. Tempting as reaching such a conclusion would be, we cannot agree that such a reading comports with the letter or spirit of *Marathon*, or with the Congressional intent of accommodation with *Marathon* which undoubtedly was an instrumental factor in the enactment of this strange and ambiguous statutory provision. Since this provision was enacted in response to *Marathon*, to conclude that § 157(b)(2) includes virtually everything, would, in the words of Judge Fox, cause us to "overlook the underlying premise of *Marathon* — which is recognition of the constitutional design of separation of powers implicit in Article III [of the Constitution]" *Earle Industries, supra*, 71 B.R. at 923.

Id. at 1018. *See also, Rosen-Novak Auto Co. v. Honz*, 783 F.2d 739 (8th Cir. 1988)(an action by a debtor against an insurer for post-petition breach of an insurance contract was non-core. Timing of contract with respect to petition not noted).

The court in *In re Sokol*, 60 Bankr. 294, 296 (Bankr. N.D. Ill. 1986) found that an action against a debtor for a post-petition breach of contact was a non-core related matter. The court noted:

> The debtor's complaint clearly is based in contract and tort. It involves state law with the only connection to the bankruptcy estate being that if the debtor prevails, the estate will have more assets to distribute to creditors . . . . [citation omitted] The fact that a debtor or estate is the plaintiff does not transform a common law contract and tort action into a turnover proceeding [citation omitted].
>
> * * *
>
> A matter that arises directly in a bankruptcy case under bankruptcy law is a core proceeding, and a matter that arises under non-bankruptcy law and happens to be of issue in a bankruptcy case merely because of the accidental fact that one of the parties to the dispute is a debtor in the bankruptcy case usually is not a core proceeding. [citation omitted] That is particularly true where, as here, the debtor is the plaintiff asserting a claim against one who asserts no creditor claim in the bankruptcy case.

Id. at 296.

The debtor in *Sokol* had argued, as did Cooper,[22] that the contract dispute was core under subsections (A), (E), and (O) of § 157(b)(2). The court rejected these classifications, and said tersely that the case had nothing to do with the administration of the estate, but merely represented an asset of the debtors. It was not a "turnover proceeding" because the cause of action was not matured, payable on demand, or payable on order. The *Sokol* court concluded that if the catchall provision "O" included the matter at issue, there would be no such thing as a non-core proceeding. All debtors' causes of action would be core proceedings, including Northern Pipeline's action against Marathon Pipe Line Company. The court bluntly and summarily noted: "The fact that the alleged breach here occurred post-petition . . . cannot

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[22] Cooper also argued below that its adversary proceeding was core under (L) "confirmation of plans."

affect the defendant's constitutional right to a determination of the dispute by an Article III court." *Id.* at 297.[23]

The post-petition nature of Cooper's suit does not render it a dispute *concerning* the administration of the estate or a matter arising in a Title 11 case. It arose *during* a Title 11 case, but is in no sense inextricably interwoven with bankruptcy law and procedures – not like, for example, a confirmation of a plan, a proof of claim, an objection to discharge, or a continuance of stay.

C. The Underlying Dispute Concerns Only Private Rights, Which Were Held In *Marathon* To Be Outside The Scope Of Article I Adjudication.

The plurality opinion in *Marathon* examined the history of article I jurisdiction and found that it was confined to three areas: territorial courts, military courts, and adjudication of "public rights." The opinion acknowledged that the boundaries of the public rights area were not susceptible of precise definition (458 U.S. at 69) but noted that precise definition was not necessary for application to the *Marathon* dispute because "a matter of public rights must at a minimum arise 'between the government and others' " *Id.* (citing *Ex parte Bakelite Corp.*, 279 U.S. 438, 451 (1929)). It was clear that the underlying dispute in *Marathon* was not one in which the government was a party. *Thomas v. Union Carbide Agr. Products Co.*, 473 U.S. 568 (1985), held that a "public right" was not limited to a matter arising between the government and others.[24]

The Court's opinion in *Granfinanciera*, however, established that the private rights doctrine expounded in *Marathon* remains a pivotal factor in the analysis of bankruptcy jurisdiction. *Granfinanciera* involved a bankruptcy trustee's right to recover a fraudulent conveyance. The recovery of fraudulent conveyances

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[23] The court in *Stallings v. Kellogg (In re Hudson Oil Co., Inc.)*, 68 Bankr. 735 (D. Kan. 1986) quotes 1 *Collier on Bankruptcy* ¶ 3.01 for the principle that *Marathon* established that Congress cannot empower an article I court to decide state-law *claims*, as opposed to state-law questions. The *source* of the cause of action is determinative.

[24] The Court there held that the public right doctrine may embrace a "private" right closely intertwined with a federal regulatory scheme which Congress is empowered to enact.

is enumerated as illustrative core matter (H) under § 157(b)(2). Nonetheless, *Granfinanciera* firmly held that the fraudulent conveyance suit did not involve a public right:

> . . . *e.g.* where the government is involved in its sovereign capacity under an otherwise valid statute creating enforceable public rights. Wholly private tort, contract, and property cases, as well as a vast range of other cases, are not at all implicated.

Granfinanciera, 109 S.Ct. at 2795 (quoting *Atlas Roofing Co. v. Occupational Safety and Health Review Comm'n*, 430 U.S. 442, 458 (1977)). *Granfinanciera* teaches that even matters delineated by the BAFJA as core matters may not be appropriate for final adjudication by an article I court under *Marathon*. Article III considerations were not directly raised in *Granfinanciera* and the Court noted that its holding did not technically answer the article III question. However, the Court's public versus private rights distinction compels the conclusion that the fraudulent conveyance action in that case, and also Cooper's claim here, must be deemed non-core and not susceptible of final article I adjudication.

Granfinanciera is, in fact, dispositive of this appeal. The Court there explained that the seventh amendment right to a jury trial and the article III entitlement to an independent tribunal are congruent. A cause of action which entails one right by necessary implication entails the other. The court of appeals below affirmed ICSP's seventh amendment jury trial right. *Granfinanciera* makes clear that ICSP is entitled to an article III or state-court forum for the trial by jury.

> Indeed, our decisions point to the conclusion that, if a statutory cause of action is legal in nature, the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal.[25]

Granfinanciera, 109 S.Ct. at 2796.

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[25] It is noteworthy that the *Granfinanciera* opinion goes further, to suggest that even the "restructuring of debtor-creditor relations in bankruptcy" may not be a public right. See n. 11, 109 S.Ct. at 2787-2798.

The Court in *Granfinanciera* held that fraudulent conveyance actions which " 'constitute no part of proceedings in bankruptcy but concern controversies arising out of it' " (quoting *Schoenthal v. Irving Trust Co.*, 287 U.S. 92, 94-95 (1932)) "resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate more than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy *res*. [citation omitted] They therefore appear matters of private rather than public right." *Granfinanciera*, 109 S.Ct. at 2798.[26]

The Court's examination of a fraudulent conveyance in the context of the private rights doctrine confirms that Cooper's suit for insurance proceeds to augment the bankruptcy *res* is not a bankruptcy proceeding but a controversy arising out of it, far removed from the process of ranking creditors which the Court sees as the true "core" of the bankruptcy powers. It is to be emphasized that the fraudulent conveyance action at issue in *Granfinanciera* arose under 11 U.S.C. § 548(a)(2). *Granfinanciera*, 109 S.Ct. at 2788. Further, a fraudulent conveyance action is an enumerated core matter. 28 U.S.C. § 157(b)(2)(H). *A fortiori*, if that action is to be non-core, as concerning a private right, the instant dispute, which does not arise under any provision of Title 11 and is not an enumerated core matter, must be deemed non-core.

The Bankruptcy Code supplies a federal procedural vehicle for dispersing funds garnered under state law. State-law contract rights are not thereby rechristened as congressionally created rights. Congress cannot relegate rights not of its own creation to a non-article III forum. *Granfinanciera*, 109 S.Ct. at 2786. The decision of the court of appeals below has resurrected the results rejected in *Marathon* and *Granfinanciera*, and must be reversed. The underlying insurance dispute is a non-core matter.

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[26] *Granfinanciera* pointed out that there was no evidence that Congress had considered the implications of classifying fraudulent conveyance actions as core proceedings. 109 S.Ct. at 2800.

III. THE BANKRUPTCY COURT IS NOT A NEUTRAL FORUM.

The court of appeals below suggested that by entering into a contract with a debtor in possession, ICSP had contracted with an officer of the bankruptcy court. A-11. That comment serves to highlight why an independent article III court is the only appropriate forum for this dispute. The notion that the bankruptcy court would resolve a dispute involving a party who is an officer of that court reflects the very type of vice which article III was intended to preclude.

By the same token, in its brief in opposition to ICSP's petition for a writ of certiorari (p.4), Cooper noted that the debtor in possession "[operates] under the aegis of [the bankruptcy court's] protection and authority." (quoting *L.A. Clarke and Sons, Inc. v. Bullock Constr., Inc. (In re L.A. Clarke and Sons, Inc.)*, 51 Bankr. 31, 33 (Bankr. D.C. 1985)). Inasmuch as the underlying insurance dispute involves, *inter alia*, an insurance company's claim for rescission, it would be inconsistent with the constitutional right to a fair and neutral forum to submit such an issue for decision to a court which views itself as charged with a congressional mandate to protect the debtor and its estate.

The danger of partiality is acute where the presiding judge lacks life tenure and salary protection. Bankruptcy judges only serve fourteen-year terms. 28 U.S.C. § 152(a)(1). More importantly, all tenure, removal, and salary provisions (*see* 28 U.S.C. §§ 152(e) and 153(a)) are created by statute. Congress, therefore, always has the power to repeal or otherwise modify those provisions. The government-dependent judge is inclined to promote the goals of the statutory scheme he or she is hired to administer. Judges should be charged only with deciding justly and correctly under the law. Precisely these considerations inform the article III requirements for an independent judiciary with life tenure and salary protection.

In addition to furthering the constitutional right of litigants to a neutral forum, article III adjudication of traditional state-law claims advances the structural separation of powers which the Framers of the Constitution strived to achieve. Allowing a

specialized legislative court to adjudicate an ordinary state common law contract claim encroaches on the proper constitutional sphere of article III judges – the exercise of the judicial power of the United States. "A judiciary free from control by the Executive and Legislature is essential if there is a right to have claims decided by judges who are free from potential domination by other branches of government." *Marathon*, 458 U.S. at 58 (citing *United States v. Will*, 449 U.S. 200, 217-18 (1980)).

The bankruptcy court clearly does not provide the elements necessary to assure the neutral forum guaranteed by article III.[27]

IV. THE STATUTORY REQUIREMENT OF *DE NOVO* REVIEW OF NON-CORE DISPUTES PROHIBITS THE CONDUCT OF JURY TRIALS IN THE BANKRUPTCY COURTS.

The BAFJA provides that non-core matters are subject to *de novo* review in the district courts. In all non-core matters, bankruptcy judges must submit proposed findings of fact and determinations of law to the district courts for entry of final orders. 28 U.S.C. § 157(c)(1). If bankruptcy judges were to conduct jury trials in non-core matters, the resultant findings of fact and rulings of law would be subject to *de novo* review in the district court. Thus, when litigants in non-core adversary proceedings are entitled to trial by jury pursuant to the seventh

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[27] Furthermore, an important goal of Chapter 11 under the bankruptcy code is to allow the debtor to continue to operate its business under a plan that will satisfy its creditors. A necessary component of this policy is encouraging third parties to do business with debtors in possession.

> . . . [T]he purpose of modern bankruptcy law . . . is to encourage the rehabilitation of an honest Chapter 11 entity, rather than to permit that entity to victimize those who attempt to fulfill the purpose of rehabilitation by doing business with the Chapter 11 debtor.

Flint Hills Foods, Inc. v. Von Der Ahe (In re Isis Foods, Inc.), 19 Bankr. 329, 330-331 (Bankr. W.D. Mo. 1982), *aff'd*, 27 Bankr. 156 (D.C. Mo. 1982); *accord Int'l Fabrics Trading Corp. v. Misty Touch, Inc. (In re Misty Touch, Inc.)*, 31 Bankr. 853 (Bankr. S.D.N.Y. 1983); *Turmail v. Yankee Motor Freight, et al. (In re Manwell)*, 62 Bankr. 533 (Bankr. N.D. Ind. 1986).

Clearly, insurers and others would be discouraged from doing business with debtors in possession if to do so means foregoing the opportunity to resolve any disputes in an article III or state court.

amendment, a second jury trial would necessarily take place in the district court. The concept of two jury trials under such circumstances, however, is unacceptable.

There are two reasons that a second jury trial may not take place. First, as many courts have reasoned, it would be a significant waste of already stretched judicial resources, with absolutely no purpose, to conduct two jury trials, one in the bankruptcy court and a second in the district court. Since the petitioners here are entitled to a trial by jury, the Court could find that reference of this non-core dispute was properly withdrawn from the bankruptcy court, for efficiency reasons, without even reaching the question of a bankruptcy court's empowerment to conduct jury trials, and the concomitant article III proscriptions. Second, and of even greater significance, the seventh amendment prohibits such re-examination of a jury's findings of fact. There is, therefore, a significant constitutional prohibition as to the conduct of two jury trials which provides an independent, valid ground for withdrawal of this non-core matter.

A. Petitioners Are Entitled To A Jury Trial In This Dispute.

The issue of petitioners' right to trial by jury is not before the Court in this case. The Second Circuit below found that petitioners were entitled to trial by jury. A-22. The respondent did not file a cross-petition for certiorari to bring before this Court the portion of the decision below that held that petitioners were entitled to a jury trial. Respondent, therefore, has conceded this point. The proposition is, indeed, indisputable.

The United States Constitution provides: "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved. . . ." U.S. Const. amend. VII. As this Court held in *Granfinanciera*, Congress may not strip litigants of their seventh amendment right to trial by jury merely by placing adjudication of certain matters in an article I forum. *Id.* at 2800.

The Court's holdings in *Granfinanciera* and *Marathon* support petitioners' right to a jury trial. In suits involving legal issues, as opposed to actions seeking only equitable remedies,

litigants are entitled to a trial by jury. *Granfinanciera*, 109 S.Ct. at 2790, n. 4. In *Marathon*, the Court held that where the defendant sought damages for breach of contract and misrepresentation, such claims were "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789 [calling for] the traditional common-law mode of judge and jury." 458 U.S. at 90 (Rehnquist, J., concurring in the judgment).

Respondent Cooper's complaint in the Adversary Proceeding alleges, *inter alia*, breach of contract and negligence claims, and seeks money damages. In its answer to the complaint, ICSP raised several affirmative defenses, including breach of contract and misrepresentation. Clearly these are legal claims under *Marathon*.

The court of appeals below correctly determined that the petitioners, having made timely demand therefor, are entitled to a jury trial, reasoning that when an insurer's liability under an insurance policy has matured, the underlying issues to be resolved are legal, not equitable. A-17. The court of appeals found the claims of co-petitioner KC "even more compelling" with regard to this issue. "It is difficult to imagine a claim that is more inherently legal" than one in which respondent seeks damages from petitioner KC for alleged negligence and malpractice. A-18.

In its recent pronouncement in *Granfinanciera*, the Court squarely held that the right to a jury trial could not be eliminated simply because the action was in the bankruptcy court, traditionally a court of equity.

> Congress cannot eliminate a party's Seventh Amendment right to a jury trial merely by relabeling the cause of action to which it attaches and placing exclusive jurisdiction in an administrative agency or a specialized court of equity.

Granfinanciera, 109 S.Ct. at 2800 (citing Gibson, *Jury Trials in Bankruptcy: Obeying the Commands of Article III and the Seventh Amendment*, 72 Minn. L. Rev. 967, 1022-25 (1988) (hereinafter "Gibson, *Jury Trials*")); *Ross v. Bernhard*, 396 U.S. 531, 538 (1970) ("legal claims are not magically converted into equitable issues by their presentation to a court of equity").

By failing to cross-petition, Cooper has conceded that petitioners are entitled to a jury trial. Moreover, following *Granfinanciera* and the precedents upon which that decision is based, the petitioners are clearly entitled to a jury trial in this dispute.

B. Conduct Of A Second Jury Trial In The District Court Is A Waste Of Judicial Resources.

Non-core proceedings in a bankruptcy court are subject to *de novo* review in the district court. Pursuant to 28 U.S.C. § 157:

> (c)(1) A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgement shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

Notwithstanding that § 157(c)(1) grants a bankruptcy judge the power to hear a non-core proceeding, that court's proposed findings must be submitted to the district court for a *de novo* review. In a case that is to be tried by a jury in the bankruptcy court, the right to *de novo* review and seventh amendment considerations would lead to a second jury trial. The resulting waste of judicial resources has led the lower courts to the reasonable conclusion that bankruptcy judges should not conduct jury trials in non-core proceedings.

> . . .[T]his court believes that the line of cases which hold that, regardless of whether the bankruptcy judge is constitutionally or statutorily empowered to conduct a jury trial, it would not be in the interest of judicial economy to permit a bankruptcy judge to conduct jury trials. [This] is the proper conclusion in light of the confusion surrounding the bankruptcy judge's power to conduct jury trials.

Acolyte Elec. Corp. v. City of New York, 69 Bankr. 155, 184 (Bankr. E.D.N.Y. 1986), *aff'd*, 1987 WL 47763 (E.D.N.Y. 1987); *accord Newman Brewing Co., Inc. v. Schmidt and Sons, Inc. (In re Newman Brewing Co., Inc.)*, 87 Bankr. 236, 239 (Bankr. N.D.N.Y. 1988)(where a jury trial was demanded in non-core proceeding, "no purpose would be served in having the bankruptcy court serve as a proposed fact finder as outlined in § 157(c)").

Thus many bankruptcy courts have concluded—without reaching the constitutional implications of an article I judge's conducting a jury trial—that non-core matters may not be tried to a jury in the bankruptcy court.

C. A Second Jury Trial In The District Court Violates The Seventh Amendment To The Constitution.

Even though the resulting waste of judicial resources is a sufficient ground to withdraw reference of this non-core matter from the bankruptcy court's jurisdiction, the constitutional prohibition against re-examination of a jury's findings of fact stands as a significant independent ground.

The seventh amendment provides that "no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law." In cases involving the adjudication of private rights, an appellate court cannot review *de novo* a jury's finding of fact. *Fairmount Glass Works v. Cub Fork Coal Co.*, 287 U.S. 474, 481 (1933); *Capital Traction Co. v. Hof*, 174 U.S. 1, 9 (1899); *United States v. Johnson*, 327 U.S. 106, 111 (1946). *See generally* Moore, 5 *Moore's Federal Practice* ¶ 38.05 [5.-7] (2d ed. 1988); 6 *Moore's Federal Practice* ¶ 59.08[6]. Since § 157(c)(1) requires *de novo* review of non-core proceedings in the district courts, the statute would be incompatible with the seventh amendment's restrictions on reexamination of jury findings if the trial were to take place in the bankruptcy court. The lower courts that have found themselves required to address this issue have recognized the anomaly and have concluded that a non-core jury trial cannot take place in the bankruptcy court.

> If, pursuant to the provisions of the Seventh Amendment, the district court may not conduct a second jury

> trial (no fact tried by a jury, shall be otherwise reexamined in any court of the United States than according to the rules of the common law), the district court will obviously not be able to fulfill its Article III responsibility and its statutory duty (28 U.S.C. § 157(c)(1)) to review *de novo* a bankruptcy judge's proposed findings of fact and conclusions of law.
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> In the absence of specific statutory authority, the bankruptcy court should not engender such constitutional conflicts by conducting jury trials in any non-core proceeding.

Hughes-Bechtol, Inc. v. Air Enterprises, Inc. (In re Hughes-Bechtol, Inc.), 107 Bankr. 552, 571 (Bankr. S.D. Ohio 1989). As noted by the Honorable Conrad K. Cyr, formerly Chief Judge of the United States District Court for the District of Maine and currently Circuit Judge for the Court of Appeals for the First Circuit, "it seems *inescapable* that *Hof* precludes a *second* jury trial at the option of the district court." Cyr, *The Right To Trial By Jury In Bankruptcy: Which Judge Is To Preside?*, 63 Am. Bankr. L.J. 53, 60 (1989)(emphasis in original)(footnotes omitted).

Petitioners have not taken any action which would give rise to an inference of consent to the bankruptcy court's jurisdiction. Petitioners recognize that if they had consented, for example, by filing a proof of claim in the bankruptcy court or by failing to object to the court's jurisdiction, they might be barred from contesting jurisdiction at this point. *Granfinanciera*, 109 S.Ct. at 2799; *Novak v. Lorenz (In re Novak)*, ____ Bankr.____, 1990 WL 97804 (N.D. Ill. June 18, 1990). In view of the fact, however, that petitioners have objected to the bankruptcy court's jurisdiction from the outset and have filed no claim against the bankruptcy estate, consent is not an issue.

Since the nature of this contract dispute is such that it is clearly non-core, that is, not for plenary adjudication in the bankruptcy courts pursuant to *Marathon* and *Granfinanciera*, it is not appropriately tried to a jury in an article I court subject to *de novo* review.

V. CONGRESS DID NOT INTEND THAT BANKRUPTCY JUDGES WOULD CONDUCT JURY TRIALS.

Independent of the seventh amendment considerations, the BAFJA and its legislative history reveal no basis for bankruptcy judges' authority to conduct jury trials. There is no statutory provision empowering article I bankruptcy judges to conduct jury trials in adversary proceedings. Likewise, there is no indication that Congress intended that jury trials would take place in the bankruptcy courts under the BAFJA. The authority of article I judges to conduct jury trials certainly is not inherent and cannot be implied. If Congress had attempted to empower bankruptcy judges to conduct jury trials, it would violate article III and the separation of powers doctrine.

A. Bankruptcy Judges Are Not Empowered By Statute To Conduct Jury Trials.

Clearly, there is no authority under the BAFJA for the conduct of jury trials in the bankruptcy courts. Congress did not include any provision empowering article I bankruptcy judges to conduct jury trials when the Bankruptcy Code was reconstituted following *Marathon*. The court below recognized the "lack of a specific statutory provision" for conduct of jury trials under the Bankruptcy Code. A-19. In *In re United Missouri Bank of Kansas City*, 901 F.2d 1449 (8th Cir. 1990), the Eighth Circuit made the same observation as to the lack of a specific provision. "The language of the 1984 Act does not grant jury trial authority." *Id.* at 1454. That court went on to find that no such authority could be implied "especially where congressional and historical support for that authority is lacking." *Id.* at 1456. The Eighth Circuit cautioned against reaching too far to find implied authority merely because Congress sought "to introduce a more efficient bankruptcy scheme." *Id.* Indeed, this Court has noted that there is an issue as to whether Congress could make such an empowerment without running afoul of article III and the separation of powers doctrine.[28]

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[28] "Nor need we decide whether, if Congress has authorized bankruptcy courts to hold jury trials in [fraudulent conveyance] actions, that authorization comports with Article III when non-Article III judges preside over them subject to review in or withdrawal by the district courts." *Granfinanciera*, 109 S.Ct. at 2794-95.

Background

Under the 1898 Act the district court retained jurisdiction over all bankruptcy matters, referring those matters over which the bankruptcy "court" had summary jurisdiction to "referees." Plenary suits, *e.g.*, those in which summary jurisdiction did not exist, were adjudicated either in district courts or state courts. In disputes before the bankruptcy referees, jury trials were not held. Thus district judges, not bankruptcy referees, presided over trials involving or related to bankruptcy proceedings. *See* Gibson, *Jury Trials*, at 971-72, and accompanying notes.

Following enactment of the 1978 Act, the bankruptcy court relied on § 1480 for its authority to conduct jury trials.[29] See 1 *Collier on Bankruptcy*, ¶ 3.01 [7][a] (15th ed. 1989) (1990 Supp.). Although *Marathon* declared the broad grant of jurisdiction to the bankruptcy court in the 1978 Act unconstitutional, the Court did not expressly hold that an article I judge, without the "essential attributes of judicial power," was prohibited from conducting jury trials under any circumstances. Thus after the *Marathon* decision there was confusion among the courts concerning whether jury trials could be conducted in the bankruptcy courts. *See, e.g.*, *Cameron v. Anderson (In re American Energy)*, 50 Bankr. 175, 181 (Bankr. D.N.D. 1985) and *Terry v. Proehl (In re Proehl)*, 36 Bankr. 86, 87 (W.D. Va. 1984)(unconstitutional for non-article III bankruptcy judges to hold jury trials); *McCormick v. American Investors Management, Inc. (In re McCormick)*, 67 Bankr. 838, 843 (D. Nev. 1986), *In re O.P.M. Leasing Services, Inc.*, 48 Bankr. 824, 828-29 (S.D.N.Y. 1985) and *Walsh v. Long Beach Honda (In re Gaildeen Industries, Inc.)*, 59 Bankr. 402, 406-07 (N.D. Cal. 1986)(constitution does not prohibit jury trials in bankruptcy courts); *see also* Gibson, *Jury Trials*, at 986-89.

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[29] 28 U.S.C. § 1480 is no longer in effect (*see* 28 U.S.C.A. § 1480 (West Supp. 1990)). Its provisions resembled the current § 1411 in part.

> § 1480. (a) Except as provided in subsection (b) of this section, this chapter and title 11 do not affect any right to trial by jury, in a case under title 11 or in a proceeding arising under title 11 or arising in or related to a case under title 11, that is provided by any statute in effect on September 30, 1979.
>
> (b) The bankruptcy court may order the issues arising under section 303 of title 11 to be tried without a jury.

The Model Emergency Rule, drafted by the Judicial Conference of the United States, was designed as a stop-gap measure to keep the bankruptcy system running while Congress "enact[ed] appropriate remedial legislation in response to . . . *Marathon*." The rule prohibited bankruptcy courts from conducting jury trials. Model Emergency Rule (a) and (d)(1)(D) (West pamphlet 1983), reprinted in 1 *Collier on Bankruptcy* ¶ 3.01 (1)(b)(vi)(15th ed. 1985). "While *Marathon* cast severe doubt on the [jury trial] issue, the subsequently adopted Model Emergency Rule contained an unambiguous prohibition on the conducting of jury trials by bankruptcy judges." Sabino, *Jury Trials in the Bankruptcy Court: The Controversy Ends*, 93 Com. L.J. 238, 239 (1988). Although the majority of bankruptcy court judges who considered the constitutionality of the Emergency Rule found it unconstitutional, it was upheld by every circuit court which considered its validity. 1 *Collier on Bankruptcy*, *supra*, at 3-19, n. 22; Ferriell, *Constitutionality of the Bankruptcy Amendments and Federal Judgeship Act of 1984*, 63 Am. Bankr. L.J. 109, 121, n. 79 (1989).

Yet when the Bankruptcy Amendments were enacted in 1984, there was no provision which addressed the jury trial issue. The "notoriously ambiguous"[30] § 1411 of the BAFJA is the only provision of the current statute that even makes reference to jury trials. Subsection (a) appears to preserve "any right to trial by jury [in] a personal injury or wrongful death tort claim" and directs that such jury trials be held in the district courts; subsection (b) appears to grant the district court the right to deny jury trials in hearings on involuntary petitions. *Id.* Thus the only section of the BAFJA that expressly addresses the question of jury trials, provides that such jury trials be conducted in the district courts.

Current Statutory Provisions

Notwithstanding that there is no provision under the BAFJA empowering bankruptcy judges to conduct jury trials, some courts have clung to the belief that bankruptcy judges still possess that statutory power: *See, e.g., In re Gaildeen Industries, Inc.*, 59

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[30] *See Granfinanciera*, 109 S.Ct. at 2789, n. 3.

Bankr. at 404-5 (N.D. Cal. No. 1986); *Baldwin-United Corp. v. Thompson (In re Baldwin-United Corp.)*, 48 Bankr. 49, 56 (S.D. Ohio 1985). Several courts have relied upon 28 U.S.C. § 1411 and the now repealed Bankruptcy Rule 9015 to "infer" the jury trial power. *See, e.g., In re McCormick*, 67 Bankr. at 843 (D. Nev. 1986). As discussed below, these courts' conclusions are not well grounded.

Rule 9015, which merely provided procedural guidelines for demanding a jury trial in bankruptcy proceedings, was enacted on April 25, 1983, pursuant to 28 U.S.C. § 2075. When the jurisdictional grant under the 1978 Act was declared unconstitutional by the Court in *Marathon*, and the BAFJA was subsequently enacted, the old Rule 9015 remained as a vestige of the 1978 Act, even though § 1480, the pre-*Marathon* basis for jury trials in bankruptcy court, had been eliminated. In its initial recommendations to the Judicial Conference, the Advisory Committee on Bankruptcy Rules did not see any need to amend Rule 9015 after the BAFJA "[b]ecause Rule 9015 only dealt with the method of requesting a jury trial not the right to a jury trial or the power of a bankruptcy judge to conduct a jury trial . . ." 107 F.R.D. 413, 418 (1985). Apparently, because some courts continued to rely on Rule 9015 as a basis for conducting jury trials in bankruptcy courts after the BAFJA, the rule was repealed in 1987.[31] This should have settled any doubts concerning statutory authorization of jury trials in bankruptcy courts under the BAFJA. *See generally* Sabino, *Jury Trials*. Certainly, after repeal of Rule

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[31] In a letter from the Advisory Committee on Bankruptcy Rules to the Hon. Edward T. Gignoux, Chairman of the Standing Committee on Rules of Practice and Procedure of the Judicial Conference dated June 23, 1986, there is the following:

> Former § 1480 of title 28 preserved a right to trial by jury in any case or proceeding under title 11 in which jury trial was provided by statute. Rule 9015 provided the procedure for jury trials in bankruptcy courts. §1480 was repealed. § 1411, added by the 1984 amendments, affords a jury trial only for personal injury or wrongful death claims, which 28 U.S.C. §157(b)(5) requires be tried in the district court. Nevertheless, Rule 9015 has been cited as conferring a right to jury trial in other matters before bankruptcy judges. In light of the clear mandate of 28 U.S.C. § 2075 that the 'rules shall not abridge, enlarge, or modify any substantive right,' the Advisory Committee abrogated Rule 9015.

114 F.R.D. 193, 215 (1986).

9015 based upon the Advisory Committee's rationale, there can be no question as to the absence of statutory empowerment for the conduct of jury trials under the BAFJA.

B. There Is No Evidence That Congress Contemplated Jury Trials In The Bankruptcy Courts Under The BAFJA.

A thorough review of the legislative history of the BAFJA, as well as the language of the statute itself, reveal that Congress did not intend for bankruptcy judges to conduct jury trials. The prior statutory authority providing for jury trials in the bankruptcy courts under the 1978 Act, 28 U.S.C. § 1480, has been effectively repealed, *see* n. 31, *supra*. *See also* King, *Jurisdiction and Procedure under the Bankruptcy Amendments of 1984*, 38 Vand. L. Rev. 675, 678 (1985). There is virtually no discussion in the congressional record regarding this issue.[32] The fragmented statements in the legislative history that do address the old § 1480 and the new § 1411 are contradictory—Congress's intent cannot be gleaned. *See* Gibson, *Jury Trials*, at 991-996; *In re United Missouri Bank*, 901 F.2d at 1455 n. 16.

Some courts have attempted to draw a negative inference from § 1411. These courts have reasoned that because § 1411 expressly assigns conduct of jury trials in wrongful death and personal injury actions to the district court, jury trials in all other actions can be conducted in the bankruptcy courts. Such reasoning is logically flawed. No negative inference can be drawn from § 1411 because article I powers cannot be implied. *Capital Traction Co. v. Hof*, 174 U.S. 1 (1899); *see also In re United Missouri Bank*, 901 F.2d at 1454-55.

In fact, the exact opposite inference can be drawn from Congress's enactment of § 1411. Had Congress believed that bankruptcy courts were empowered to conduct jury trials, it would not

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[32] In *Lerblance v. Rodgers (In re Rodgers & Sons, Inc.)*, 48 Bankr. 683 (Bankr. E.D. Okla. 1985), the court relied in part upon comments made by Senators Dole and DeConcini concerning Congress's intent vis-a-vis § 1411(a) and jury trials in an interview following enactment of BAFJA. As noted in 1 *Collier Bankruptcy Manual*, ¶ 3.01 [7][b][i] at 3-99, n. 172, these comments can hardly "be taken to constitute legislative history."

have created a procedure whereby personal injury and wrongful death claims would be tried by juries in the district courts. If anything, this evidences a recognition on Congress's part that jury trials should not be conducted in the bankruptcy courts. Congress simply knew, following *Marathon*, that to permit jury trials in bankruptcy courts encroached into the judiciary's purview and would violate article III.

VI. THE CONDUCT OF JURY TRIALS BY ARTICLE I BANKRUPTCY JUDGES VIOLATES ARTICLE III OF THE CONSTITUTION.

There is a fundamental constitutional prohibition against an article I bankruptcy judge's presiding over jury trials in ordinary state law disputes. The *Granfinanciera* Court recognized that the seventh amendment right is congruent with the right to an article III forum. The bankruptcy courts, which today handle a broad range of matters, including many ordinary state-law disputes, are not an appropriate exception to the proscriptions that article III imposes upon legislative courts established by Congress pursuant to its article I powers. Those exceptions all involve narrowly defined specialty "courts" that are wholly different from the bankruptcy courts.

A. The Seventh Amendment Right To Trial By Jury Is Concomitant With The Right To Adjudication In An Article III Forum.

Contrary to the Second Circuit's opinion below, the *Granfinanciera* decision does not expressly sanction the conduct of jury trials by article I bankruptcy judges. In that recent opinion, in fact, the Court expressly left open the question of which forum is appropriate for the exercise of the seventh amendment right which it upheld. *Granfinanciera*, 109 S.Ct. at 2802. A careful analysis of the opinion, coupled with what this Court said in *Marathon* leads to one conclusion: bankruptcy judges cannot conduct jury trials.

Although a majority of the *Marathon* Court did not agree with all aspects of Justice Brennan's plurality opinion, a majority

did agree that an action for breach of contract arising under state law cannot properly come "before the Bankruptcy Court only because the plaintiff has previously filed a petition for reorganization in that court." *Marathon*, 458 U.S. at 90 (Rehnquist, J. concurring in judgment). "It is clear that, at the least, the new bankruptcy judges cannot constitutionally be vested with jurisdiction to decide this state-law contract claim against Marathon." *Id.* at 87, n. 40. Yet under the new bankruptcy scheme which was ostensibly designed by Congress to solve the constitutional infirmities highlighted in *Marathon*, the same situation has arisen and comes before this Court.

The Court's mandate was that "Congress . . . determine the proper manner of restructuring the Bankruptcy Act of 1978 to conform to the requirements of Art. III." Many legal scholars have expressed the view that Congress did not succeed. *See, e.g.*, King, *Jurisdiction and Procedure, supra* at 678; Countryman, *Scrambling to Define Bankruptcy Jurisdiction: The Chief Justice, The Judicial Conference, and the Legislative Process*, 22 Harv. J. on Legis. 1 (1985). Yet, one can give proper meaning and effect to the BAFJA in a manner that is consonant with *Marathon* and in keeping with constitutional considerations. *See* discussion in Points I and II, *supra*.

Concomitant with the seventh amendment right to a jury trial is the right of adjudication before an article III tribunal.

> Congress' power to [assign resolution of claims it creates to forums where jury trials are not available] is limited, however, just as its power to place adjudicative authority in non-Article III tribunals is circumscribed. . . . Indeed, our decisions point to the conclusion that, if a statutory cause of action is legal in nature, the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal. *For if a statutory cause of action, such as respondent's right to recover a fraudulent*

> *conveyance . . . is not a "public right" for Article III purposes, then Congress may not assign its adjudication to a specialized non-Article III court lacking "the essential attributes of the judicial power."*

Granfinanciera, 109 S.Ct. at 2796 (citations omitted) (emphasis added). The Court went on to conclude that the converse holds true. If an action can properly be committed by Congress to adjudication in a non-article III tribunal (presumably an action involving "public rights"), then the seventh amendment "poses no independent bar to the adjudication of that action by a non-jury factfinder." *Id.*

As discussed in Point II, *supra*, the case at bar, however the dispute might be characterized under the BAFJA, involves only private contract rights between individuals. It does not "arise between the Government and persons subject to its authority" as public rights were defined in *Granfinanciera*. The Court concluded in *Granfinanciera* that the fraudulent conveyance claims were private. Congress therefore could not strip the petitioners of their seventh amendment jury trial right. Since the Court stated that the seventh amendment right is concomitant with Article III adjudication, the only possible conclusion is that the bankruptcy power, insofar as state-created, "private" causes of action are concerned, cannot be used by Congress to restrict article III rights. Thus clearly Congress's power to place adjudicative authority over petitioners' state law claims in the non-article III bankruptcy court is circumscribed. *See Granfinanciera*, 109 S.Ct. at 2796.

Given the Court's finding in *Granfinanciera* that a fraudulent conveyance action "was not integrally related to the reformation of debtor-creditor relations," *id.* at 2800, petitioners' ordinary state-law claims for breach of contract and misrepresentation, and respondent's negligence claims – which fall even further from the "core" of bankruptcy proceedings – should most certainly have the full benefit of seventh amendment guarantees and article III adjudication.

Petitioners are entitled to a jury trial under the seventh amendment because the rights involved are "private" pursuant to

Granfinanciera. If the seventh amendment right is inexorably tied to the right to adjudication in an article III court, as the Court stated in *Granfinanciera*, then the adjudication of petitioners' claims cannot be assigned by Congress to the bankruptcy court, in which an article I judge presides.

B. Allowing Non-Article III Judges To Conduct Jury Trials In Bankruptcy Courts Would Dangerously Erode The Independence Of The Judicial Branch.

The prospect of bankruptcy judges, who sit in the Congressionally-created article I courts, conducting jury trials strikes at the very core of our Constitution. To protect against the tyranny that would result from the accumulation of legislative, executive, and judiciary powers in the same hands,

> the Framers provided that the Federal Government would consist of three distinct Branches, each to exercise one of the governmental powers recognized by the Framers as inherently distinct. . . . The Federal Judiciary was therefore designed by the Framers to stand independent of the Executive and Legislature – to maintain the checks and balances of the constitutional structure and also to guarantee that the process of adjudication itself remained impartial.

Marathon, 458 U.S. at 57-58. Separation of the three distinct branches lies at the heart of the Constitution's framework. "[O]ur Constitution unambiguously enunciates a fundamental principle – that the 'judicial Power of the United States' must be reposed in an independent Judiciary." *Id.* at 60. Independence of the judiciary continues to be of paramount concern.

Pursuant to article III, the power of the judiciary is vested in the Supreme Court, "and in such inferior Courts as the Congress may from time to time ordain and establish." art. III, §1. "The inexorable command of this provision is clear and definite: The judicial power of the United States must be exercised by courts having the attributes prescribed in Art. III." 458 U.S. at 58-59. Included as necessary attributes of the judiciary are the tenure and salary protections:

> The Judges, both of the supreme and inferior Courts, shall hold their Offices during good behavior, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office.

U.S. Const., art. III, § 1. The tenure and compensation clauses ensure an independent judiciary free from control by the other branches of government:

> Next to permanency in office, nothing can contribute more to the independence of the judges than a fixed provision for their support. . . . In the general course of human nature, *a power over a man's subsistence amounts to a power over his will.*

Marathon, 458 U.S. at 60 (citing The Federalist No. 79, p. 491 (H. Lodge ed. 1888)(A. Hamilton)(emphasis in original)); *see also id.* at 59-60, n. 10 and 11. Lacking article III, § 1 qualifications, bankruptcy judges cannot exercise article III functions, including the conduct of jury trials.

Although the Court has upheld the right of Congress to delegate some adjudicatory functions to non-article III tribunals, it has done so only in extremely limited circumstances: all of these "exceptions," as discussed below, are clearly distinguishable from the matters at issue in this case. The Court in *Marathon* carefully analyzed and distinguished the three narrow categories of "courts" which constitute exceptions to the article III mandate. Because the "congressional assertion of a power to create legislative courts [in these limited areas] was consistent with, rather than threatening to, the constitutional mandate of separation of powers" 458 U.S. at 64, the Court has upheld the non-article III territorial courts (including the District of Columbia courts), the military courts, and the legislative courts and administrative agencies which adjudicate congressionally created "public rights". *Marathon*, 458 U.S. at 64-69.

C. The Limited Exceptions To The Prohibition Against Vesting Article III Powers In Article I Courts Do Not Justify Conduct Of Jury Trials By Article I Bankruptcy Judges.

Neither the legislative courts, nor administrative agencies, nor the powers of magistrates acting as adjuncts to the district courts are analogous to the bankruptcy courts. The administrative agencies deal with congressionally created rights and pervasive regulatory schemes in specialized areas. The bankruptcy courts, on the other hand, are qualitatively different from any of the administrative agencies. "If Justice Brennan did in fact make the implicit prediction that bankruptcy cases were potential battlegrounds, he has been proven correct. Bankruptcy courts today are where major social policy issues – compensation for victims of asbestosis, toxic waste cleanups, and labor relations – are being played out." Resnik, *The Mythic Meaning of Article III Courts*, 56 U. Colo. L. Rev. 581, 615 (1985). Administrative agencies, such as the E.P.A. in *Thomas v. Union Carbide* or the Commodity Futures Trading Commission in *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 883 (1986), promulgate and enforce regulations created by act of Congress. In contrast, bankruptcy judges are not merely adjudicating rights created by Congress as part of a pervasive regulatory scheme or public entitlement. Rather, under the broad construction placed upon the BAFJA by the court below and the First Circuit in *Arnold Print Works*, bankruptcy judges are hearing a range of disputes, many of which are between private litigants over common law claims.

Although the non-article III judges have been delegated authority to conduct jury trials in certain specific instances, those circumstances are not apposite here. As a general rule, findings of federal magistrates are subject to *de novo* review by the district courts. *U.S. v. Raddatz*, 447 U.S. 667, 673-77 (1980). Magistrates may conduct jury trials in a narrow range of matters and only upon express written consent of all parties to a proceeding. 28 U.S.C. §§636(a)(3) and (c). Some cases have held that the written consent requirement satisfies article III limitations upon Congress's power to delegate adjudicatory functions. *Collins v.*

Foreman, 729 F.2d 108 (2d Cir. 1984). In other actions, however consent has not sufficed. *Ford v. Estelle*, 740 F.2d 374 (5th Cir. 1984).[33]

The territorial courts are one historical exception to the article III prohibition on Congress's ability to delegate judicial functions to article I tribunals. In 1828 the Court recognized that article IV § 3 grants sole power to Congress to establish governments in the territories which are not within the states. *American Ins. Co. v. Canter*, 1 Pet. 511 (1828). In fact, the *Canter* decision has been blamed for opening the door to numerous difficult constitutional questions.[34] The same rationale was applied to uphold the District of Columbia non-article III courts. *Kendall v. United States*, 12 Pet. 524 (1838); *see* discussion in *Marathon*, 458 U.S. 64-65. Today, "territorial" article IV courts include courts in the United States territories, for example, Guam and the Virgin Islands. *Id.* These courts are limited in number; they serve specific purposes. The District of Columbia Courts, while established pursuant to powers granted to Congress under article I, are anomalous. Those courts are really most like the state courts because Congress is granted the sole power to establish the government and laws within the District.

There is little danger of Congress's usurping the role of the article III courts by the exercise of its power through the narrowly carved exceptions for the territorial or legislative courts. Furthermore, whereas legislative courts and administrative agencies are specialized, matters which arise in the bankruptcy courts represent the full range of civil litigation. All varieties of contract, negligence, and commercial law matters would be tried by article I judges if the bankruptcy courts were allowed to conduct jury trials. The threat of significant erosion of article III is great.

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[33] It should be noted that the Court has not decided the constitutionality of a magistrate's conducting a jury trial upon consent of the parties.

[34] "Justice Marshall's opinion in *Canter* opened a Pandora's box that has, on numerous occasions, required the Court to determine the limits of the powers of such tribunals in a way that preserves their efficacy while at the same time imposes meaningful restrictions upon Congress' ability to delegate too much judicial power to courts whose judges lack the protections and thus the independence that article III was designed to foster." Ferriell, *Constitutionality of the Bankruptcy Amendments to the Federal Judgeship Act of 1984*, 63 Am. Bankr. L.J. 109, 122 (1989) (footnotes omitted).

CONCLUSION

> Congress cannot withdraw from Article III judicial cognizance any matter which from its nature, is the subject of a suit at common law, or in equity or admiralty.

Murray's Lessee v. Hoboken Const. & Improvement Co., 18 How. 272, 284 (1856).

This Court's message to Congress in *Marathon* was unambiguous: article III rights are to be jealously guarded. *Granfinanciera* further emphasized that, however one denominates a claim and notwithstanding that happens to be pending in an article I court, constitutional guarantees will remain paramount.

The manner in which the Second Circuit has applied the BAFJA to the underlying dispute has resurrected the concepts which were rejected in *Marathon* and *Granfinanciera*. Its endorsement of a broad-sweeping article I bankruptcy jurisdiction embracing state common-law disputes involving private rights, poses a threat to article III. If anything is clear from *Marathon* and its progeny, it is that article III guarantees must be safeguarded.

For the foregoing reasons, the judgment of the court below that this is a core proceeding and that the jury trial may be conducted in the bankruptcy court should be reversed and the ruling of the district court should be reinstated.

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